LO.a: Explain uses of industry analysis and the relation of industry analysis to company analysis.

1. Industry analysis is *most* useful to those who are engaged in:
   A. indexing approach.
   B. passive investment strategy.
   C. portfolio performance attribution.

2. Which of the following is *least likely* a use of industry analysis?
   A. Understanding a company's business environment.
   B. Identifying passive investment opportunities.
   C. Portfolio performance attribution.

LO.b: Compare methods by which companies can be grouped, current industry classification systems, and classify a company, given a description of its activities and the classification system.

3. Which of the following companies would be *best* classified as a consumer discretionary company?
   A. Health care equipment manufacturer.
   B. Beverage manufacturer.
   C. Apparel manufacturer.

4. Which of the following companies is the *most appropriate* member of the utilities sector?
   A. A semiconductor company.
   B. A provider of wireless broadband services.
   C. A regulated provider of water services.

5. Which of the following *best* describes how a company can be classified based on Global Industry Classification Standard (GICS)?
   A. Company →industry →sub-industry→industry group→sector.
   B. Company→sub-industry→industry group→ industry→sector.
   C. Company→sub-industry→industry→ industry group→sector.

6. The aircraft manufacturing industry can *most likely* be characterized as:
   A. Concentrated.
   B. Fragmented.
   C. Segmented.

7. All the statements below are correct about Russell Global Sectors, except:
   A. Classification is based on products or services.
   B. It contains ten sectors.
   C. It is based on a three-tier layer classification system.

8. Which of the following statements *most accurately* describes the difference among the three commercial classification systems?

   A. ICB uses a three-tier structure classification system while RGS uses a four-tier structure.
   B. RGS classifies based on where a company gets its revenue whereas ICB classifies based on products or services.
   C. GICS and ICB use a four-tier structure while RGS uses a three-tier structure.

9. Which of the following is *least likely* a limitation of classifying companies based on statistical similarities?
   A. Difficulty in identifying securities with returns that are correlated.
   B. Falsely excluding a significant relationship.
   C. Falsely indicating a relationship where none exists.

10. Which of the following statements about commercial and government industry classification systems is *least accurate*?
    A. Commercial classification system is reviewed more frequently as compared to government classification system.
    B. Government classification system generally distinguishes between large and small businesses while commercial system does not.
    C. A limitation of both the systems is that a company's narrowest classification unit cannot be assumed to be its peer group.

LO.c: Explain the factors that affect the sensitivity of a company to the business cycle and the uses and limitations of industry and company descriptors such as "growth," "defensive," and "cyclical".

11. Analyst 1: During recessions, consumers are more likely to defer purchases of products of defensive companies than of cyclical companies.
    Analyst 2: During recessions, non-cyclical companies tend to outperform cyclical companies.
    Which analyst's statement is *most likely* correct?
    A. Analyst 1.
    B. Analyst 2.
    C. Both.

12. For a pharmaceutical company like GlaxoSmithKline, a company that sells medical devices can be categorized as:
    A. part of a sector.
    B. principal business activity.
    C. a company offering similar product/ services.

13. Earnings of which of the following companies is *most* dependent on the stage of the business cycle?
    A. Growth.
    B. Defensive.
    C. Cyclical.

14. Which of the following is *most likely* a limitation of classifying companies based on business cycle sensitivity?
    A. Cyclical companies generally do not have a growth component.
    B. Different regions of the world might be at different stages of the business cycle.
    C. Cyclical/non-cyclical business cycle is a discrete spectrum.

LO.d: Explain how a company's industry classification can be used to identify a potential "peer group" for equity valuation

15. A peer group is constructed through a process:
    A. that identifies a group of companies whose valuation is influenced by diverse factors.
    B. that starts with an existing commercially classified system that is then narrowed.
    C. that groups companies by a relationship that occurs by chance.

16. Which of the following statement about constructing a peer group is *least* accurate?
    A. Constructing a peer group is a straightforward and objective process.
    B. A peer group consist of companies engaged in similar business activities.
    C. A company could belong to more than one peer group.

LO.e: Describe the elements that need to be covered in a thorough industry analysis.

17. Analyst 1: In industry analysis, we classify industries by life-cycle stage and identify whether it is embryonic, growth, shakeout, mature, or declining.
    Analyst 2: In industry analysis, we consider external factors that affect industries, which include demographic, macroeconomic, governmental, social, and technological influences.
    Which analyst's statement is *most likely* correct?
    A. Analyst 1.
    B. Analyst 2.
    C. Both.

LO.f: Describe the principles of strategic analysis of an industry.

18. Which of the following is *not* one of Porter's five forces?
    A. Bargaining power of customers.
    B. Product/service substitution threats.
    C. Technological influences.

19. Industry competition is less intense and firm profitability is greater when there is:
    A. more rivalry among existing industry firms.
    B. less bargaining power of customers.
    C. more bargaining power of suppliers.

20. As an equity analyst, you are presented with the following statements about two industries:
    i. Industry 1 has a few companies producing relatively homogenous products; high income elasticity of demand; high capital costs and investments in physical plants; rapid shifts in market shares of competing firms; and minimum regulatory influence.

ii. Industry 2 has a few companies with proprietary technologies, differentiated products with unique features, high switching costs, and minimum regulatory influence.

Based on the information provided in these two statements, it is *most* reasonable to conclude that compared to firms in Industry 1, those in Industry 2 would potentially have:

A. larger economic profits.
B. over-capacity problems.
C. high bargaining power of customers.

LO.g: Explain the effects of barriers to entry, industry concentration, industry capacity, and market share stability on pricing power and price competition.

21. Which of the following characteristics is *most likely* to be exhibited by the industry that is experiencing intense competitive rivalry among incumbent companies?
    A. Customers basing purchase decisions largely on price.
    B. Small number of suppliers with high bargaining power.
    C. Substitute products available with low exit barriers.

22. Which of the following *most accurately* results in increased competition within an industry?

	Barriers to Entry	**Capacity**	**Concentration**
A.	Low	Unused	Low
B.	High	Unused	Low
C.	High	Near full capacity	High

23. With respect to competitive strategy, a company with a successful cost leadership strategy is *least likely*:
    A. to have efficient production systems.
    B. to have a high cost of capital.
    C. to have tight cost controls.

24. Which of the following industries is *most likely* to be characterized as fragmented with strong pricing power?
    A. Semiconductor equipment.
    B. Private Banking.
    C. Commercial printing.

25. Which of the following companies *least likely* has the greatest ability to quickly increase its capacity?
    A. Brokerage house.
    B. Investment advisor.
    C. Grocery store.

26. An industry with fierce competition and little or no differentiation in products is *most likely* categorized as:
    A. fragmented with weak pricing power.

B. concentrated with strong pricing power.
C. fragmented with strong pricing power.

27. Tight or limited capacity of an industry leads to:
    A. high pricing power.
    B. price cuts.
    C. no effect on prices.

28. An industry that *most likely* has high barriers to entry and high barriers to exit is the:
    A. sugar industry.
    B. clothing industry.
    C. education industry.

29. Under which of the following scenarios are we *mostly likely* to observe high pricing power?
    A. High barriers to entry and high barriers to exit.
    B. High barriers to entry and low barriers to exit.
    C. Low barriers to entry and low barriers to exit.

30. Which of the following statements is *least accurate* about market share stability?
    A. Stable market shares indicate low level of price competition.
    B. Pace of innovation in an industry impacts market share stability.
    C. High switching cost leads to volatile market shares.

LO.h: Describe product and industry life cycle models, classify an industry as to life cycle phase (embryonic, growth, shakeout, maturity, and decline), and describe limitations of the life-cycle concept in forecasting industry performance.

31. According to the industry life-cycle model, an industry experiencing industry consolidation, high barriers to entry and little or no growth is *most likely* in its:
    A. decline stage.
    B. maturity stage.
    C. shakeout stage.

32. Which of the following is *most likely* a characteristic of embryonic stage of an industry?
    A. Medium growth.
    B. Low prices.
    C. Insufficient volumes.

33. According to the industry life-cycle model, the growth phase is *most likely* characterized by:
    A. industry consolidation.
    B. falling prices.
    C. intense competition.

34. Which of the following industries can *most likely* be classified as cyclical?
    A. Non-discretionary consumer goods industry.
    B. Pharmaceutical industry.

C. Auto Industry.

35. Which of the following life-cycle phases is *most likely* categorized by intense competition?
    A. Shakeout.
    B. Mature.
    C. Growth.

36. In which of the following life-cycle phases are prices most likely to be high?
    A. Mature.
    B. Growth.
    C. Embryonic.

37. Which of the following is *least likely* a characteristic of mature stage?
    A. Industry consolidation.
    B. Little or no growth.
    C. Low barriers to entry.

38. An industry characterized by rapidly increasing demand, improving profitability, and falling prices is *most likely* in its:
    A. embryonic stage.
    B. maturity stage.
    C. growth stage.

LO.i: Compare characteristics of representative industries from the various economic sectors.

39. In the event of expected economic slowdown and diminishing growth rates with respect to revenues and profits, an equity fund manager will *most likely* make changes to the portfolio by:
    A. overweighting technology stocks.
    B. overweighting consumer staples.
    C. underweighting utilities.

40. An analyst is reviewing the restaurant industry. Which of the following characteristics about the industry is the analyst *least likely* to observe?
    A. Fierce competition.
    B. Fragmented structure.
    C. High barriers to entry.

41. Which of the following industries is *most likely* considered to have high price competition?
    A. Oil service industry.
    B. Branded pharmaceutical industry.
    C. Confectionary industry.

LO.j: Describe macroeconomic, technological, demographic, governmental, and social influences on industry growth, profitability, and risk.

42. Which of the following can be *least likely* categorized as an external factor that influences an industry?
    A. Social influences.
    B. Rivalry among existing competitors.
    C. Government.

43. Which of the following industries is *most likely* to be considered to have major influence due to changes in demographics?
    A. Branded pharmaceuticals.
    B. Oil service.
    C. Confectionary industry.

44. A country's population that is rapidly getting rich, would *most likely* cause the growth rate of the automobile industry to:
    A. decrease.
    B. increase.
    C. remain same.

45. When women entered the work force in the US, the restaurant, child care, and women's clothing industries were dramatically affected. This example can be best classified as a:
    A. demographic factor.
    B. technological factor.
    C. social influence.

LO.k: Describe the elements that should be covered in a thorough company analysis.

46. A company is presented with two capital investment projects:
    i. To replace existing machinery with productivity-improving capital equipment.
    ii. To establish strong market research teams to match customer needs with product development.

    Both projects require the same initial outlay. If the company chooses the first project it *most likely* pursues a competitive strategy of:
    A. differentiation.
    B. cost leadership.
    C. focus.

47. Which of the following statements about company analysis is *least accurate*?
    A. The complexity of the spreadsheet model may make it appear that the conclusions or stock price forecasts are right, when in fact it may be not.
    B. The corporate profile would include a description of the company's business, investment activities and governance only.
    C. Analysis of demand for products/services include sources of demand, differentiation, long term outlook.

48. Which of the following statements most accurately depict a company pursuing the differentiation strategy?
    A. Strong market research teams to match customer needs with product development.
    B. Tight cost controls with highly efficient operating and reporting systems.
    C. Investment in productivity improving capital equipment.

49. Which of the following is *least likely* to be included in a comprehensive company analysis report?
    A. Pricing environment.
    B. Demand of the product in the market.
    C. Major financial investments made by board members.

Solutions

1. C is correct. Indexing and passive investing strategies would not engage in over- or underweighting of industries, industry rotation, or timing investments in industries. Therefore, industry analysis is not useful to such investors or portfolio managers. Performance attribution, which addresses sources of a portfolio's returns, utilizes industry analysis and classification.

2. B is correct. Industry analysis is used in identifying active investment opportunities.

3. C is correct. Consumer discretionary companies derive a majority of revenue from the sale of consumer-related products or services for which demand tends to exhibit a relatively high degree of economic sensitivity. An apparel business would be an example of a business activity that falls into this category.

4. C is correct.

5. C is correct. E.g. Exxon Mobil – integrated oil & gas (sub industry) – oil gas & consumable fuels (industry) –energy (sector)

6. A is correct. Since there are only two major companies (Boeing and Airbus), this industry can be classified as concentrated.

7. B is correct. RGS contains nine sectors whereas GICS contains 10 sectors because telecommunication service is included as part of utilities sector.

8. C is correct. GICS and ICB use a four-tier structure while RGS uses a three-tier structure. B is incorrect because RGS classifies based on the products and services a company produces.

9. A is correct. This classification actually makes it relatively easy to identify securities which are correlated. Options B and C represent limitations.

10. B is correct. Government classification system does no distinguish between large and small businesses, for-profit and non-profit, or private and public companies.

11. B is correct. During recession, non-cyclical companies tend to outperform cyclical companies. Consumers are more likely to defer purchases of products of cyclical companies than of defensive companies.

12. A is correct.

13. C is correct. The performance of companies with cyclical demand for their products is highly variable and depends on economic conditions.

14. B is correct. Different regions of the world might be at different stages of the business cycle.

15. B is correct. The process consists of initially starting with commercial classification systems and then filtering it to the companies operating in the chosen industry.

16. A is correct. Constructing a peer group is a subjective process.

17. C is correct. Both statements are correct.

18. C is correct. This is not one of the five internal forces though it is part of external forces.

19. B is correct. Industry competition is less intense and firm profitability is greater when there is (1) less rivalry among existing industry firms (2) less bargaining power of customers (3) less bargaining power of suppliers.

20. A is correct. The economic profit (which is computed as the spread between return on capital and the cost of capital) tends to be larger in industries with differentiated products, greater pricing power, and high switching costs to consumers. Firms in Industry 2 have these features, whereas firms in Industry 1 have the exact opposite conditions.

21. A is correct. The factor that most influences customer purchase decisions is likely to also be the focus of competitive rivalry in the industry. In general, industries where price is a large factor in customer purchase decisions tend to be more competitive than industries in which customers value other attributes more highly.

22. A is correct. Low barriers to entry increase competition as they allow new entrants. Unused capacity results in intense price competition. Low concentration refers to a fragmented market which increases competition.

23. B is correct. For a successful cost leadership strategy, a company should have efficient production systems and tight cost controls. The cost of capital should be low.

24. B is correct. Private banking is relationship-based. Hence pricing power can be high.

25. C is correct. The other two require no investment to expand their business whereas for a grocery store, investment on shelves and other things would be required.

26. A is correct.

27. A is correct. Tight or limited capacity results in high pricing power as demand exceeds supply.

28. A is correct. Sugar industry requires heavy investment therefore has high barriers to entry and exit.

29. B is correct. Option A is not correct as illustrated by the auto industry

30. C is correct. High switching cost leads to stable market shares.

31. B is correct. An industry experiencing industry consolidation, high barriers to entry and little or no growth is in maturity stage.

32. C is correct. An embryonic industry is one that is just beginning to develop and is characterized by slow growth, high prices, and volumes not yet sufficient to achieve meaningful economies of scale, developing distribution channels, and low brand loyalty as there is low customer awareness of the industry's product.

33. B is correct. A growth industry is characterized by rapidly increasing demand, falling prices, improving profitability, and relatively low competition among companies operating in the industry. Prices fall in the growth stage because economies of scale are achieved and the distribution channels develop.
    Industry consolidation is a feature of the maturity phase while intense competition characterizes the shakeout stage.

34. C is correct. Of the three industries listed the revenue/profits of the auto industry are most likely to rise/fall with overall economy.

35. A is correct.

36. C is correct.

37. C is correct. Mature stage has high barriers to entry and there is little or no growth. It is also likely that industry consolidation takes place.

38. C is correct. A growth industry tends to be characterized by rapidly increasing demand, improving profitability, falling prices, and relativity low competition among companies in the industry.

39. B is correct. Non-cyclical companies produce goods or services for which demand remains relatively stable throughout the business cycle. The consumer staples sector exhibits relatively less economic sensitivity and thus tends to be over-weighted during economic slowdowns and when revenues and profits are expected to be under pressure.

40. C is correct. Restaurants industry is characterized by low barriers to entry because anyone with a modest amount of capital and some culinary skill can open a restaurant. The industry, however, is fragmented which can lead to fierce competition and weak pricing power.

41. A is correct. The oil service industry is most likely to have high price competition.

42. B is correct. Rivalry among existing competitors is an internal factor of Porter's five forces.

43. A is correct. The demand for drugs increases as the population increases.

44. B is correct. More spending will be made on purchasing automobiles.

45. C is correct. The given example can be best classified as a social influence.

46. B is correct. Cost leadership entails minimizing costs and transferring the benefits of these reduced costs to consumers. In this manner, the company maintains slim margins, but generates its profitability through high volume. Since the company has preferred the strategy of improving productivity rather than marketability, the likelihood is that the company pursues a cost-leadership strategy.

47. B is correct. The corporate profile would include a description of the company's business, investment activities, governance and strengths and weaknesses.

48. A is correct. Companies pursuing the differentiation strategy try to establish themselves as manufacturers or service providers of something unique in quality, type or means of distribution. This requires strong market research teams to identify and match customer needs with product development and marketing. Tight cost controls, highly efficient systems and investment in productivity improving capital are characteristics of a firm pursuing the cost leadership strategy.

49. C is correct. Major financial investments made by board members is least likely to be included in a comprehensive company analysis report.